DEFERRED COMPENSATION PLAN

This program is a voluntary benefit and provides a convenient way for City employees to save money for retirement. Money is deducted from the employee's payroll check before taxes are taken out (reducing taxable income) and is invested for the employee, per his/her direction through the enrollment process. This program was established under Section 457 of the IRS Code. All City employees are eligible to participate. Once an employee has invested the money, the law does not allow him/her to take it out of the program until he/she retires, terminates employment with the City, dies, or experiences an unforeseeable financial hardship. (See the upcoming section "Financial Hardship" for more information on that subject.) The City also offers a loan provision, by which employees can borrow money from the plan. **This is not a regular savings account.**

Plan Description

The Deferred Compensation Plan is a written agreement between the employee and the City. It allows employees to defer and invest part of their wages, and not pay taxes on this money until the money is received. At that time, presumably, the employee will be in a lower tax bracket and will therefore pay less tax on the money than if it was received now in the employee's present tax bracket.

Deferred Compensation Plan Advantages

The program also allows the interest on the employee's invested money to accumulate tax-free until the money is distributed to the employee. This deferral of taxes allows employees to invest more money than they could afford to invest if they used after-tax dollars for savings. It also allows the earnings on an employee's investment to accumulate faster than it would if it was taxed in the year it was earned. The complete text of the Deferred Compensation Plan can be found in Chapter 3.48 of the San Jose Municipal Code.

In the long term, this program helps employees to:

- Reduce current tax liability.
- Accumulate more money than is usually possible with after-tax savings methods.
- Supplement retirement income. This program does not affect employees' City Retirement System program or contributions in any way. By participating, however, employees can supplement the amount of money they will have to spend during retirement.

Investment of Your Deferred Wages

An Advisory Committee manages the investments of deferred wages. This committee establishes contracts with companies offering appropriate investment vehicles. Employees may request that their money be invested in a particular area. However, the final determination of investment vehicles available at any given time is made at the sole discretion of the Advisory Committee.

Employees' deferred income is placed in an account established for them with the administrator they have selected. All payroll deductions and interest earnings are credited to the account. All assets are held by the City in trust for the exclusive benefit of the participants and beneficiaries of the plan.

Maximum Amount of Deferral

Under federal law, the **maximum** amount that may be deferred in calendar year 2007 is $15,500. This **maximum** will increase $500 annually thereafter. Contributions can be 100% of gross compensation or a dollar limit not to exceed the contribution in effect for the current year. The **minimum** amount that may be deferred is $25 per pay period.

Pre-Retirement Regular Catch-Up Provision

There is an exception to the maximum limitation rule. During the three (3) years before the year designated as the employee's normal retirement age, he/she may exceed the maximums described above in order to make up for years when he/she did not invest the maximum amount for which he/she was eligible. This is called the Regular Catch-Up Provision.

Catch-Up Rules

Catch-Up Provision rules are as follows:

1. The employee may defer the difference between what he/she was eligible to defer and what was actually deferred from January 1, 1979, to the present.

   A calculation is required to determine eligibility for this provision. Please contact Deferred Compensation in Human Resources (City Hall Wing, 2nd Floor, 975-1465) for further information.

2. The total annual deferral during the Catch-Up period may not exceed twice the normal annual contribution limit in effect for the current year. The Catch-Up limit for 2007 is $31,000. In 2008 and later the annual maximum will be a cost of living increase in $1,000 increments. This includes the maximum amount employees are allowed to defer during the current year, plus the eligible Catch-Up amount.

3. Regular Catch-Up can begin three years prior to normal retirement age.

Catch-Up Provision for Employees Aged 50+

Individuals who are currently age 50 or older, or who will turn age 50 in the calendar year, may contribute an additional $5,000, for a total of $20,500 for 2007. In 2008 and later the annual maximum will be a cost of living increase in $500 increments. Participants may not use this provision if they are using the above Regular Catch-Up Provision.

Deferred Income Investment Options

Employees have several choices for investing their deferred income. Contact Deferred Compensation at (408) 975-1465 or the ING local office at (408) 881-0110 for details. Employees may transfer their money between investment options at any time.

How to Enroll

Employees have three options for enrollment and may enroll anytime during employment:

Enroll on-line through the City's Intranet site: www.csj.gov/eway. This option is only available within 30 days of the date of hire. No paper forms are required.

For individual appointments, brochures and program details, contact Deferred Compensation in Human Resources (City Hall Wing, 2nd Floor, 975-1465) or the ING local office at (408) 881-0110.

Meet with the ING provider representative, who is available in City Hall every Wednesday from 9:00 to 3:00 and certain other locations at scheduled times. Call the ING local office at (408) 881-0110 for the current schedule.

Making Per Paycheck Deferral Changes

Paycheck deferral amounts can be made on-line through the City's Intranet site: www.csj.gov/eway. No paper forms are required.

Payroll check deductions for deferred compensation will begin according to the IRS "first-of-the-month" rule. The "first-of-the-month" rule requires that a participant, requesting a first time deferral, an increase of deferral or restart of deferral, makes the election before the first of the month in which the deferrals occur. Therefore, elections entered or submitted, between the 1st and last day of the month, will be deferred from paychecks in the following month.

NOTE: If the contribution is being changed to zero, the first-of-the-month rule does not apply, and the deduction will be effective within two (2) paychecks.

Distribution Options

Under certain circumstances, the value of the account may be distributed to the employee as the employee elects. If the employee leaves the City to work for another employer in the State of California who has an eligible 457 deferred compensation plan, the employee may elect to transfer his/her funds to the new employer. See the section on “Pay-Out Options” for more information.

Here are some of the reasons a distribution may be requested:

- Death (payment to beneficiary)
- Retirement
- Separation from City service
- Financial hardship (See the upcoming section "Determination of Financial Hardship" for more information on this subject.)
- Residential and General Purpose Loans (See the upcoming section “Loan Provision” for more information on this subject.)

Within thirty (30) days following separation from of City employment employees must decide how to proceed with their deferred compensation balance. Employees may not receive funds in the same month that they separate from service.

Determination of Financial Hardship

Employees may withdraw funds from their deferred compensation account prior to retirement only in some cases of financial hardship. Section 457 of the Internal Revenue Code defines financial hardship as the "occurrence of an unforeseeable emergency" that causes severe financial hardship to the employee or his/her dependents and is not covered by other insurance. It also states that financial hardship is not intended to include the use of funds to purchase a home or send children to college.

Financial Hardship Withdrawal

To apply for a hardship withdrawal, contact ING’s customer service number at (800) 584-6001.

Loan Provision

There are two types of loans available: General Purpose and Residential. General Purpose loans can be used for any reason and have a maximum repayment period of 5 years. Residential loans must be used for the purchase or renovation of your primary residence and have a maximum repayment period of 20 years. The City’s loan program allows for a maximum of one of each type of loan to be outstanding at any one time. The minimum loan amount is $1,000 and the maximum loan amount is 50% of the employee’s account value or $50,000, whichever is less.

To request a loan, contact ING’s customer service number at (800) 584-6001.

Income Tax Rules

The money deferred, and the income earned on this money, is subject to income tax at the time the money is received. Under current IRS regulations, distributions from Deferred Compensation **may** be "rolled over" into an IRA, 403(b), 401(a) and/or 457(b) governmental Deferred Compensation plan.

Pay-Out Options

Employees may choose to have their benefits paid to them in one or more of the following ways:

- A single lump sum.
- Partial Distribution.
- In equal monthly, quarterly, semiannual, or annual installments of $50 or more, over a pre-selected period.
- Various lifetime annuity options (see the enroller for details). Fractional Payments.
- Postponement of payments until a future date, not beyond age 70 1/2. After postponement, employees select from the options listed above.

If payment is not delayed, payment of benefits may start as soon as thirty-one (31) days after termination of employment, but no later than sixty (60) days after the end of the calendar year in which the employee terminates employment.

Post-Retirement Earnings

The employee’s retirement account will continue to earn interest after retirement (unless all money in the fund was withdrawn in a lump sum at the time of retirement).

If a "pre-selected period" pay-out is chosen, the enroller will calculate the projected growth of the account at anticipated interest rates based on the length of the pay-out period selected. This calculation will be used to establish the amount of the payments received from the account. Any excess earnings due to higher-than-anticipated interest returns after retirement will increase the payment amount received.

If you choose a "pre-selected amount" pay-out, the amount of each payment will not change, but the length of the pay-out period may vary. Any excess earnings due to higher-than-anticipated interest returns after retirement will extend the number of payments you receive.

Beneficiary Designations

Beneficiary designations on deferred compensation accounts should be reviewed after any major life changes. The City's *Beneficiary Designation* form supersedes wills, so designations should be kept current at all times.
If the employee is married and his/her spouse was not named as beneficiary, the spouse may have community property rights to the account funds unless the spouse signs an acknowledgement that he or she is not a beneficiary.